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Remarks of J. L. Robertson

Member of the Board of Governors
of the
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of the
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The Reform of Bank Supervision

It is a pleasure to be in Tennessee again - a state that has had more than its fair share of the national spotlight in recent months. First, there was the opening of Tennessee Williams' new hit on Broadway, "The Night of the Iguana", which met with general critical acclaim. And then there was the great drama which was recently acted out in the marble chambers of the Supreme Court in Washington. Borrowing Tennessee Williams' style and some of his poetic license, we might title it "The Twilight of the Gerrymander". It was greeted with a sharper division of opinion on the part of the reviewers. Six of them thought that Tennessee ought to revise the script, though they did not say exactly how the job might be done.

That is often the way with critics. It is always easier to oppose than to propose. We all know this from our personal experience. Your wife asks a simple question, "What would you like for dinner, dear?" Nine times out of ten you are completely stumped and respond with that very evasive answer, "Oh, just anything at all. Your meals are always wonderful!"

Of course, when the dinner is served, you can think of any number of ways in which it falls short of perfection - but if you value your life you keep these critical observations to yourself. Uncle Remus fans may recall the lines, "Tar Baby ain't saying nuthin, en Brer Fox, he lay low." Sometimes that is a good policy to follow when we feel the urge to criticize.

Thomas Carlyle seemed to be supporting this approach to criticism when he wrote, "Silence is as deep as eternity. Speech is as shallow as time." On the other hand, Carlyle elsewhere gave this imperious and rather contradictory command: "Produce! Produce! Were it but the pitifullest infinitesimal fraction of a product, produce it...! 'Tis the utmost thou hast in thee. Out with it then."

Today I am torn between this conflicting advice - but I cannot "lay low" and "say nuthin", even if silence is as deep as eternity. I know we are all friends, but this

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is not a Quaker meeting, and I am committed to a speech. I must therefore follow Carlyle's second admonition.

But I have an even better reason for deciding to speak today. Recently I have become more and more convinced that if our country is to maintain its position of leadership in the free world, develop an economy that can provide work opportunities for all who are willing and able to work, and eliminate our balance of payments problems, each of us - not just those in a position to cope with major issues, but each of us - must make the right decisions in the role which he plays in our society, be it large or small. Every aspect of our economic, social, and political life must be constantly improved. We cannot afford to drift, in the belief that what we have is good enough. This means, among other things, that public officials - like me - must seek to improve government rather than to maintain the status quo for the sake of whatever power it provides.

As most of you know, I have labored in the field of bank supervision for nearly thirty years - two decades with the Office of the Comptroller of the Currency (at times I was Acting Comptroller, and as such an _ex officio_ Director of the Federal Deposit Insurance Corporation), and one decade with the Federal Reserve System. Perhaps my long experience in the field qualifies me, in some degree, to take upon myself the critic's mantle, and to make some suggestions designed to improve and strengthen the federal system of bank supervision. I hope they will constitute something more than the "pitifullest infinitesimal fraction of a product".

Everyone is aware of the fact that federal bank supervision, like the banking system itself, has grown up like Topsy; that it is divided among several agencies, with resulting overlapping, inefficiencies, inconsistencies, and conflicting policies. The only reason that the bad aspects of this sort of hodgepodge arrangement have not been more noticeable is that over the years federal bank supervision has been characterized, with rare exceptions, by an understanding that the successful operation of this intricate

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arrangement requires a high degree of comity and cooperation, together with an atmosphere of candor, patience, tolerance, and willingness to work harmoniously to solve the difficult problems that constantly arise. However, the fact that the system has been made to work as well as it has does not argue for the proposition that public officials like myself should not examine the machinery with the view of devising a better arrangement, one that will be effective in carrying out the will of Congress, as expressed in the banking laws, and shaping the banking structure in a manner best suited to financing a dynamic economy.

Recently I have undertaken this task. And at the risk of estranging people with whom I have long been associated in government, as well as many friends in the banking industry throughout the country, I feel obliged to disclose my conclusions, for whatever value they may have.

As I see the picture, the time has arrived when we, as a nation, must determine the kind of a banking system we want, whether it be a continuance of many independent units, a rapid development of branch banking, or perhaps a rapid development of holding company banking. We must decide whether, in view of the changing size of business units in this country, we wish to have a few large banks with many branches (with a relatively few men dominating the entire banking system and local offices operated by subordinates), or to continue the existing system of numerous institutions and opportunities for many men to reach the top and formulate banking policies. We need a supervisory structure that will make it possible to face these issues squarely, reach decisions courageously, and implement them equitably. We must review and analyze those laws regarding bank supervision which give rise to overlapping functions, powers, and agencies, to inconsistent decisions, and to a "race of laxity" which too often reduces supervisory standards to the "lowest common denominator".

Such an analysis leads me - as it has led others before me - to a conclusion which for many years I have sought to avoid, namely, that all federal supervision of commercial banks should be performed by one agency. This is not

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a new idea. It has been the subject matter of bills introduced in Congress by Senator Weeks as early as 1919, by Representative McFadden in 1920, Senator Smathers in 1938, and Representative Ditter in 1939. It was the subject of reports by the Brookings Institution (to a Committee of the Senate headed by Senator Byrd) in 1937, the Hoover Commission in 1949, and the CED's Commission on Money and Credit in 1961. And some of you will remember that in 1938 the crazy-quilt pattern of federal bank supervision was the major subject of the Federal Reserve's Annual Report.

Some of the past proposals would have concentrated bank supervisory powers in the Federal Reserve, some in the Federal Deposit Insurance Corporation, and still others in the Comptroller of the Currency. Plausible arguments can be made for and against each of the proposals. For example, some feel that the expenses of such a consolidation of functions could most easily be met out of surplus Federal Reserve funds which otherwise would be transferred to the Treasury; others weigh heavily the fact that the Federal Deposit Insurance Corporation has an insurer's interest in the soundness of practically all banks; and others stress the view that it is easier to deal with a single administrator, like the Comptroller of the Currency, than with a Board of three or seven men.

On the other hand, (1) in appraising the soundness of loans or investments, bank examiners should never be obliged to switch from rose-colored glasses to black ones, and back and forth again, in an effort to implement the monetary policy of the moment; (2) it is doubtful that all banks should be examined by an agency primarily concerned with its insurance risks and obligations; and (3) it is questionable that exclusive control over all federal bank supervisory matters should be vested in one individual.

Unfortunately, efforts designed to bring order out of the situation by unraveling some of the overlapping cross-lines of authority have been enshrouded in (and so impeded by) clouds of emotion, pique, fear of loss of power, and charges of power-grabbing.

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I am quite aware that the proposal I am making now may stir up these emotions. However, I am convinced that the people of this country will not - and should not - be satisfied with a system that by its very structure almost invites pettiness and bickering, in which one group of banks can be played against another, and where, in the name of equity and fairness, bank supervisory standards are increasingly reduced to the level of the lowest or most lenient.

There is another reason why I think action - either by the President, under the Reorganization Act, or by the Congress - is necessary. During the past few years we have witnessed a wave of mergers, and at the moment a wave of applications to create new bank holding companies. How these applications are dealt with may determine the future banking structure of the country. We face a crossroads decision calling for wisdom and foresight, for equity and substantial competitive equality.

Today three different federal agencies pass upon applications for mergers, and notwithstanding the fact that each of them receives the views of the other two and of the Department of Justice with respect to the competitive factors, their decisions do not reflect uniform application of statutory standards and factors. It is impossible for anyone, in my judgment, to analyze all of the merger cases decided by the three agencies in the past year and come out with an understandable pattern of decision.

One of the reasons for this is that the decisions are being made by men with different points of view, but another equally strong reason is that they are being made by men whose minds are almost fully occupied with other things of equal or even greater importance.

Take, for example, the Board of Governors of the Federal Reserve System. All of the members of that Board, on which I have the honor to serve, have <u>more</u> than a full-time job just keeping abreast of ever-changing economic conditions and developments, in this country as well as

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abroad, and developing or adjusting economic policies to fit the changing circumstances and needs. Still they are required to spend at least as much time analyzing very complicated bank supervisory problems and merger and holding company applications. In one case alone, which was decided recently, the documents before the Board, including statistical tables and the record of hearing, piled more than six inches high. It is not uncommon for a member of the Board to have to read and analyze hundreds of pages of material in a single case. Conscientious men can shoulder, for a while, these different and ever-expanding tasks - each of which demands careful, objective, and time-consuming analysis and thought - but we must be concerned lest their sheer volume serves to diminish the quality of judgments and decisions, the importance of which cannot be overstated.

In view of all this, and after painful soul-searching, I have reached the conclusion that there should be established a new agency of government - perhaps to be called the Federal Banking Commission. It would be headed by five Commissioners, each to be appointed by the President, with the advice and consent of the Senate, on a staggered-term basis. To it should be transferred all the bank and bank holding company supervisory powers presently vested in the Federal Reserve Board, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation. The latter two would be completely absorbed into the new Commission, except for the currency functions of the Comptroller's Office, which should be transferred to the Federal Reserve.

The Commission would have all the jurisdiction now exercised by the existing agencies over charters, branches, mergers, holding companies, fiduciary and foreign banking activities, as well as disciplinary actions such as termination of "insurance" or "membership", and removal of officers or directors. It would also promulgate all regulations which are now required or authorized to be issued by any of the three supervisory agencies, and it would otherwise administer and interpret the federal banking laws.

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A unit of the new Commission, headed by a Director of Insurance, would handle the deposit insurance and related functions now performed by the FDIC. The Director would be a career man appointed by and responsible to the Commission.

There also would be a separate unit of the Commission, headed by a Director of Bank Examinations. He would be in charge of all examiners, now employed by the Comptroller of the Currency, the FDIC, and the Federal Reserve System. Since the Director of Examinations, like the Director of Insurance, should be a career man, with an indefinite term of office, he, too, should be appointed by and be accountable to the Commission. His job would be to see that every national bank was effectively examined, that the laws of the land were obeyed, and that the regulations of the Commission were complied with. In addition, he would be authorized and required to examine state member and nonmember insured banks to the extent deemed necessary for any reason by the Federal Banking Commission, the Director of Insurance, or the Federal Reserve Board, and, of course, all reports of examinations would be made freely available to all three.

In addition, the Director of Examinations would be required to submit to the Commission his report and recommendation with respect to every charter, branch, merger, and holding company application. He would be expected to act as an advocate of the public interest in connection with quasi-judicial proceedings of the new agency on such applications, so that the Commission would have before it not only the facts and self-serving arguments advanced by the applicant, but also the more objective arguments of those representing only the public interest. He would be expected to report to the Commission any instance in which an insured bank is engaging in unsound practices or violations of law that might warrant the institution of disciplinary proceedings. He would refer to the Commission for its determination any questions for interpretation of law arising in connection with examinations of insured banks.

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One of the facets of the problem that has bothered me for some time is the way in which Congress has provided for the financial support of bank supervision. At the present time the expenses of the Office of the Comptroller of the Currency are borne by the supervised national banks on an assessment basis. The expenses of the FDIC are borne by the funds obtained through assessments against insured banks, and the costs of Federal Reserve supervision are paid out of Federal Reserve funds, involving no assessments on the banks examined.

When a supervisory agency is financed by the organizations being supervised, there is always the danger, usually latent but sometimes emergent, that the agency will treat as wards the institutions it supervises, or assume the role of a trade association - a role that is unbecoming a federal agency. Furthermore, I question whether banks should be burdened with examination costs; the purpose of supervision is to protect the public interest, rather than the banks or their shareholders. Consequently, I propose that the Commission and all of its activities, other than insurance, be supported entirely by appropriated funds (the cost of providing federal deposit insurance would still be covered by assessments on all insured banks).

Of course, one of the questions which always looms up when a plan such as this is discussed is: What happens to the dual banking system? My answer is simply that, if the dual banking system is to be maintained, federal bank examinations eventually should be confined to national banks, except to the extent that the Federal Reserve, the Federal Banking Commission, or its Director of Insurance, might need to have examinations made of state banks in order to aid them in the performance of their statutory duties.

At the present time most states do not have supervisory forces large enough to examine their state-chartered banks without material assistance from either the Federal Reserve System or the FDIC. Consequently, the withdrawal

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of federal examination in those states would have to be gradual. I would suggest that a goal of three years be set within which those states could develop their examining staffs to the point where they could assume the full burden of supervising state banks. After that, assuming the Federal Banking Commission is satisfied with a State Supervisor's reports of examinations, federal examinations of banks in that state would not be made - except perhaps for spot-checking.

This sort of an arrangement would achieve greater uniformity and effectiveness - as well as reduce the cost - of federal bank supervision, eliminate conflicting interpretations of law, and lead to greater consistency in merger and holding company policies. Since all merger applications, for example, which are now passed upon by one or another of the three federal bank supervisory agencies, would be dealt with, instead, by the new Federal Banking Commission, it seems likely that the decisions would be more consistent and would provide better guidance to the banking industry. Such an arrangement would also serve to eliminate a substantial part of the temptation for banks to switch from state to national, member to nonmember, or vice versa, depending upon which group appears to receive the most generous or lenient treatment from the federal supervisor.

The new Commission would be almost exclusively concerned with quasi-judicial functions calling for a high degree of knowledge of the banking industry, as well as the ability to analyze both facts and law. Consequently, its membership should be selected with the same care that is called for in the selection of judges. Decisions of the Commission should be final and conclusive, unless found by a reviewing court to be wholly without evidentiary support or clearly arbitrary and capricious.

Some may think that it would be better to have a single administrator of such an agency, for the sake of speed, efficiency, and uniformity. My own view is that the problems involved - for example, in a charter, merger, or holding company application, as well as in the promulgation of regulations - are so important not only to the individuals and

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institutions involved but also the public and to the direction of the development of banking in this country, that they demand the judgment of more than one mind. Every man is tied to some degree to his special background and experience, and consequently is not wholly free from bias and prejudice. Therefore, I believe the public interest is best served by requiring that the minds of several men be focused on each problem - even at the expense of some delay and awkwardness.

Where would this plan leave the Federal Reserve System? Exactly where it is - as the central bank of this country - except that its examination and supervisory functions would be transferred to the new Commission. This would relieve the Federal Reserve System of a great deal of work, which, while important, is not essentially interrelated with its primary function of regulating the supply of money and credit. In my view, there are few functions in a capitalistic economy more important than this. If, for any reason, the flow of money and credit is too large in relation to the volume of goods and services available for purchase, inflation usually results. Everyone now is aware of the consequences which flow therefrom - most of them evil. On the other hand, the failure of money and credit to keep pace with the growing needs of the economy can result in the under-utilization of our vast resources, excessive unemployment, and - in extreme cases - economic chaos.

We all know that monetary policy alone cannot stabilize the economy. Equally important are many other factors, such as fiscal policy, public psychology, the spending and savings habits of people, and the pressures of labor and businesses (including agriculture). But I do believe monetary policy is one of the most potent and is essential as an equalizer among the others. It is sufficiently important that the Board of Governors of the Federal Reserve System should be permitted to devote all of its time and effort to the task, without diverting attention to bank supervisory matters that demand concentrated full-time attention by people especially qualified for the job.

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In concluding, let me state clearly that the views I have expressed are exclusively my own, reached without consulting either my associates on the Board of Governors or the officials of any other agency. Having worked closely with all of them for many years, it is only natural that I feel great affection for each of the agencies and the people who run them. However, in formulating these views, I have been obliged to look to my mind and my conscience, rather than my heart, and abide by their dictates.

I do not know what will come of this proposal. To borrow a phrase from Dickens, I hope that "It mayn't be human gore!" I am sure that everyone will agree that there is a job to be done. But there are alternative ways of doing it. I can only bring to bear on the problem the lessons I have learned from experience, in the years that have transformed an upstart from Broken Bow, Nebraska, into one of Washington's elder bureaucrats. Someone else may develop a better solution. But of one thing I am certain, we will never find the <u>right</u> solution unless we are willing to put aside rancor, personalities, and politics, as well as rigid resistance to change, and proceed to debate the issue with all the open-mindedness of which we are capable.

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